Eagle Insight

EAGLE Asset Management
AN AFFILIATE OF CARILLON TOWER ADVISERS

Large Cap Core

First Quarter | 2018

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Market Overview

January's record highs gave way to fear of a trade war, a more hawkish Federal Reserve and the long-awaited return of volatility. A swift mid-quarter retreat in leading technology names rattled investors and motivated many to shift from a "risk-on" to a "risk-off" approach.

One of the main takeaways from the first quarter is that volatility is back. The VIX index (a volatility metric derived from the price of S&P 500 options) had the lowest annual average on record in 2017[i]. Many investors were caught off guard as strategies designed to capitalize on the long-standing low-volatility environment were part of a violent unwind. Volatility spiked and the VIX ended the quarter at more than double its 2017 average. The combination of central bank tightening, rising inflation, and geopolitical risks, means that volatility is almost certain to be higher this year.

Much of the recent news for the U.S. economy remains bullish. In the short term, the new tax cuts will benefit many Americans, the spending bill should add to economic growth and in the long-term it is difficult to forecast the impact of larger deficits. FactSet estimates that first-quarter S&P 500 earnings grew by 17.3 percent, which would be the highest earnings growth since the first quarter of 2011.

Portfolio Review[1,2]

Eagle's Large Cap Core outperformed (on a gross basis) the benchmark S&P 500 Index. Sector allocation contributed the majority of performance and stock selection was also positive. Underweight positions in real estate and energy contributed to performance. Stock selection was strongest within industrials and information technology but weak within healthcare and consumer staples.

Amazon.com, the world's largest online retailer, benefitted from strong retail sales in North America. Its revenue results exceeded consensus expectations, driven by performance in its higher-margin advertising, third-party and web-service businesses.

Northrop Grumman increased its dividend and is expected to benefit from increased defense spending. The company's pending acquisition of Orbital ATK, which is expected to boost revenue, also prompted upgrades.

Microsoft's focus on cloud computing and its Azure cloud platform contributed to strong growth and margins for the company.

Raytheon, a U.S. military contractor offering defense and aerospace systems, reported a strong outlook for 2018 on expectations that it will benefit – along with other defense companies – from a supportive administration in Washington, D.C.

Software company Adobe is expected to benefit from favorable tax rates. Strength in its latest cloud-based subscription software in digital media and digital marketing also helped the company.

CVS Health stocks were among those hurt by reports that Amazon, Berkshire Hathaway and JPMorgan Chase will be collaborating to provide health care services within the United States. Subdued guidance also weighed on the share price, despite CVS beating earnings expectations.

Facebook is facing criticism over the security of user data, following the news that Cambridge Analytica violated Facebook rules, collected user data using the Facebook app and lied about deleting it. Cambridge Analytica is banned from the social media platform.

The risks associated with Large Cap Core investing are based on the expectation of positive price performance due to continued earnings growth or anticipated changes in the market or within the company itself. However, if a company fails to meet that expectation or anticipated changes do not occur, its stock price may decline. Moreover, as with all equity investing, there is the risk that an unexpected change in the market or within the company itself may have an adverse effect on its stock. Investing in growth-oriented stocks involves potentially higher volatility and risk than investing in income-generating stocks. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

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Discount retailer Walmart was hurt by slowing e-commerce growth in its most recent quarter, despite strong comparable sales growth and beating revenue expectations.

Building materials company Owens Corning saw its share price sink due to weaker margins in the company's insulation segment.

Homebuilder D.R. Horton released above-expected earnings, but fell along with other home builders due to a reported slump in new-home sales and rising industry costs.

Outlook[1]

Stocks may face hurdles in the short term, even when the news is positive on many macro fronts.

Some investors may be concerned that the economy is nearing the end of the cycle as valuations become increasingly stretched after eight years of growth. That said, economic growth and earnings still appear strong and many surveys of U.S. investors still suggest plenty of optimism, even after the recent market correction. Adding to the already complicated picture, the government has enacted substantial fiscal stimulus at a time when the economy is at essentially full employment.

The Federal Open Market Committee (FOMC) indicated a continued steady pace of interest rate increases as well as an upward trajectory in its economic projections. However, the timing of the fiscal stimulus – coming much later in the cycle than is typically the case – does elevate the risk of inflation, which could push the FOMC to tighten more quickly.

President Donald Trump significantly shifted U.S. policy by proposing tariffs on steel, aluminum and Chinese imports. U.S. businesses source roughly 40 percent of their revenues from overseas[ii] so any disruption in global trade could be very damaging. We also see this as a dangerous development for global markets as trade wars tend to be stagflationary: often simultaneously slowing growth and stimulating inflation. We are hopeful that the situation won't deteriorate further, as both Canada and Mexico are exempt and it appears the U.S. is also negotiating exemptions for the European Union (EU) and Australia. Regardless, the saber-rattling on all sides has clearly unnerved some investors.

On the plus side, the U.S. economy – in our view – should have a tailwind due to the tax cuts that Americans are now incorporating into their budgets. We avoided another government shutdown as a new spending bill passed; while the bill's merits can be debated, it should add to near-term economic growth.

The market of 2017 that let negative news just roll off its back now appears to have given way to one that is more sensitive to a variety of issues. But, as we've noted, last year was the exception and this year is closer to the norm. In our view, sell-offs and increased volatility are indicative of a healthier investing environment that could help extend the current growth cycle. Valuations, which were somewhat extended at the end of 2017, have had the chance to consolidate in part due to the market correction and the strength in corporate earnings. Our outlook for 2018 remains net positive.

[1] References to specific securities are intended to illustrate the types of securities Eagle may hold in this portfolio. They are not intended as representations of specific investment recommendations that would have been profitable to an investor. Past performance is not a guarantee of future results.

Top 10 Holdings

Microsoft
JPMorgan Chase
Apple
Amazon.com
Bank of America
Northrop Grumman
UnitedHealth
Home Depot
Raytheon
Applied Materials

The information provided above should not be construed as a recommendation to buy, sell or hold any particular security. The data is shown for informational purposes only and is not indicative of future portfolio characteristics or returns. Portfolio holdings are not stagnant and may change over time without prior notice. Past performance does not guarantee future results. Please note that the holdings identified do not represent all of the securities purchased, sold or recommended for the composite. They are provided for informational purposes only. Eagle, its affiliates or their respective employees may have a position in the securities listed. Please contact your financial advisor to obtain the calculation's methodology and/or a list showing every holding's contribution to the overall composite's performance during the measurement period.

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	Top Securities	Average Weight (%)	Security Contribution to Portfolio Return	Bottom Securities	Average Weight (%)	Security Contribution to Portfolio Return
Large Cap Core	Amazon.com	2.63	0.46	CVS	1.28	-0.23
	Northrop Grumman	2.34	0.29	Facebook	2.21	-0.21
	Microsoft	4.35	0.28	Walmart	1.89	-0.21
	Raytheon	2.00	0.27	Owens Corning	1.40	-0.17
	Adobe	1.34	0.26	D.R. Horton	1.19	-0.17

* as of March 31. The information provided above should not be construed as a recommendation to buy, sell or hold any particular security. The data are shown for informational purposes only and are not indicative of future portfolio characteristics or returns. Portfolio holdings are not stagnant and may change over time without prior notice. Past performance does not guarantee future results. Please note that the holdings identified do not represent all of the securities purchased, sold or recommended for the composite. They are provided for informational purposes only. Eagle, its affiliates or their respective employees may have a position in the securities listed. Please contact your financial advisor to obtain the calculation's methodology and/or a list showing every holding's contribution to the overall composite's performance during the measurement period.

[2] Source: FactSet

[i] Source: Reuters

[ii] Source: Bloomberg